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IN THE

Supreme Court of the United States

OCTOBER TERM 1936

No. 97.

UNITED STATES OF AMERICA,
Petitioner,

v.

PERCY K. HUDSON,
Respondent.

RESPONDENT'S BRIEF.

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RESPONDENT'S BRIEF.

Introductory Statement.

This case is presented upon an agreed stipulation of facts. Respondent purchased certain futures contracts for the delivery of silver on May 3, 1934, and sold them at a profit May 23 and 29, 1934. There was no Federal law imposing any special tax on such transactions in force at the time. The Silver Purchase Act of 1934, which levied a tax of 50% of the profits accruing from transfers of interests in silver, was not passed until June 19, 1934.

The Act, however, contained a retroactive provision. It taxed profits on transfers of interests in silver made on and after *May 15, 1934.* Under this retroactive provision, respondent was assessed and paid a tax of $4,311.00. Respondent filed an adequate claim for refund with the Commissioner of Internal Revenue based on the ground

that the provision in the statute applying the tax to transactions, like the present, which were completed before the enactment of the statute, was unconstitutional; but his claim was rejected. He sues to recover the amount of the tax, with interest and costs. The Court of Claims, on November 4, 1935, found respondent entitled to recover the amount of tax he had theretofore paid.

Statute Involved.

The statute involved is Sub-division 10 of Schedule A of Title VIII (the Stamp Tax Title) of the Revenue Act of 1926, as added by Section 8 of the Silver Purchase Act of 1934. The statute is set forth in full in Appendix A of the Government's brief. The more pertinent provisions of the statute are as follows:

> "*Section 800 of the Revenue Act of 1926:*
>
> * * * there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person who makes, signs, issues, sells, removes, consigns or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned or shipped, the several taxes specified in such schedule. * * *
>
> 10. *Silver, and so forth, sales and transfers.*—On all transfers of any interest in silver bullion, if the price for which such interest is or is to be transferred exceeds the total cost thereof and allowed expenses, 50 per centum of the amount of such excess. * * *

> * * * This subdivision shall apply * * * (2) with respect to all transfers of any interest in silver bullion on or after May 15, 1934, and prior to the enactment of the Silver Purchase Act of 1934, except that in such cases it shall be paid by the transferor in such manner and at such time as the Commissioner, with the approval of the Secretary of the Treasury, may by regulations prescribe, and the requirement of a memorandum of such transfer shall not apply. * * *"

The Silver Purchase Act was enacted at 9 P. M. on June 19, 1934.

Summary of Argument.

I.

Under the authority of *Untermyer* v. *Anderson,* 276 U. S. 440, Congress may not constitutionally (within the Fifth Amendment) levy an excise tax on the profits realized by the respondent on transfers which were made and completed prior to the date of enactment of the taxing Act.

II.

The Government's attempt to distinguish the *Untermyer* case is unsuccessful; (a) the retroactive application of the Silver Profits Tax is not supportable as a monetary measure; (b) the Silver Profits Tax is not the kind of tax on income which can be imposed retroactively.

Argument.

I.

Under the authority of Untermyer v. Anderson, 276 U. S. 440, Congress may not constitutionally (within the Fifth Amendment) levy an excise tax on the profits realized by the respondent on transfers which were made and completed prior to the date of enactment of the taxing act.

The retroactive tax levied against respondent in the instant case is unconstitutional under the due process clause of the Fifth Amendment to the United States Constitution.

Untermyer v. *Anderson,* 276 U. S. 440 (1928).

The *Untermyer* case is decisive of the present case. The action was brought by the taxpayer to recover from the Collector of Internal Revenue the amount of a tax paid on gifts made by the taxpayer. The tax had been assessed pursuant to the gift tax provisions of the Revenue Act of 1924. The gifts in question were made on May 23, 1924, and the Revenue Act was enacted on June 2, 1924. No Federal Gift Tax was in effect prior to such day. The gift tax provisions had been introduced in Congress on February 25, 1924, and accordingly had been under consideration by the House and the Senate for almost three months when the gifts were made. In fact the final conference report of the two Houses, which provided for the gift tax, had been made at the time that the gifts were effected.

It had previously been held, in *Blodgett* v. *Holden,* 275 U. S. 142 (1927), modified 276 U. S. 594 (1928), that the gift tax provisions of the Revenue Act of 1924 were invalid under the due process clause of the Fifth Amendment in so far as they applied to a gift made in January, 1924, prior to the introduction of the gift tax provisions in Con-

gress. The *Blodgett* decision, however, left open the question of whether a gift made after the gift tax provisions were introduced in Congress, but before the Act was finally passed, could constitutionally be taxed. This was the question presented in the *Untermyer* case.

This Court held that the tax assessed in respect of the gifts made May 23, 1924 was invalid because it was so arbitrary that its enforcement would amount to a confiscation of property without due process of law within the inhibition of the Fifth Amendment to the Constitution of the United States.

The collector in the *Untermyer* case had argued that the need for revenue for the Federal Government was so great, and the power of Congress to raise revenue was so broad, that the retroactive gift tax should be upheld. This argument was rejected by the Court.

A second argument advanced by the collector was that Congress had power to establish a retroactive gift tax in order to prevent tax evasions. It was pointed out that one of the favorite methods of evading was to split up large incomes by gifts among members of a family, thus escaping the higher, progressive rates of tax imposed by the Federal income tax law and estate tax laws. Without this method of preventing evasion, Congress, it was stated, would not be able adequately to exercise its power to tax. The Court also overruled this argument of the collector.

A third argument advanced by the collector was that the taxpayer, having made the gift after the Congressional conference report had been made and just a few days prior to the final enactment of the gift tax, must be held to have acted with an intention of avoiding the tax; and that where such an intention could be presumed, the tax should

be upheld. The Court rejected this argument of the collector, stating at pages 445 and 446, that such a result

> "would produce insuperable difficulties touching interpretation and practical application of the statute, and render impossible proper understanding of the burden intended to be imposed. The taxpayer may justly know when and how he becomes liable for taxes —he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken."

The basis of the *Untermyer* decision, as explained in *Milliken* v. *United States,* 283 U. S. 15 (1931), is that the nature and amount of the tax burden imposed could not have been understood and foreseen by the taxpayer with reasonable definiteness at the time of the particular voluntary act which was made the occasion of the tax. Mere retroactivity, it was conceded, may not be enough in some cases to make the tax so arbitrary as to be unconstitutional. Thus, for example, where a particular tax, such as the income tax, has been in force year after year so that the taxpayer is acquainted with its general nature and realizes that the rate of tax varies from year to year, a limited retroactivity will be upheld. The element of surprise is negligible. But where a novel tax is involved—such as the Gift Tax was in 1924 and the Silver Purchase Act Tax was in 1934—Congress cannot constitutionally make the tax apply retroactively to completed transactions.

It will thus be seen that the *Untermyer* case is decisive of the instant case, and requires that the Silver Purchase Act of 1934, in so far as it attempts to tax transfers con-

summated prior to the date of enactment, be held so arbitrary and capricious as to be invalid under the due process clause of the Fifth Amendment.

In the instant case, the respondent had purchased his silver contracts before the Silver Purchase Act of 1934 had been introduced in Congress or even publicly suggested for introduction by the President of the United States. No Federal excise tax of any kind on profits from dealings in silver was in force prior to the Silver Purchase Act of 1934. That Act introduced an unusual and extraordinary feature into the Federal tax system. Several of respondent's transactions were consummated on May 23, 1934 before the Act had even been introduced in the United States Senate. The other transactions were consummated on May 29, 1934 before the Act had been passed by either House of Congress. No evidence whatsoever has been shown that respondent carried on his silver transactions with a view to evading the Silver Purchase Act of 1934; in fact all of his purchases were made prior to the Presidential message first suggesting enactment of such an Act by Congress. The retroactive feature of the Act would apply equally to a transfer of silver which had been purchased years before a silver tax had even been considered.

All of the factors present in the *Untermyer* case, upon which the Court relied in reaching its decision that the gift tax if applied retroactively was unconstitutional, are present to an even greater degree in the instant case and impel a decision that the Silver Purchase Act of 1934, in so far as it attempts to levy a retroactive tax on the respondent, is invalid.

II.

The Government's attempt to distinguish the Untermyer case is unsuccessful.

The Government contends that the retroactive silver profits tax is distinguishable from the retroactive *gift* tax held invalid in the *Untermyer* case on the grounds that (A) the retroactive application of the silver profits tax is supportable as a monetary measure whereas in the *Untermyer* case the tax was purely for revenue; and (B) the silver profits tax is an income tax and this court has held that *income* taxes can be imposed retroactively.

Neither of these contentions is sound. Although the present tax is a species of tax on income it is not an income tax in the ordinary sense. It is only an income tax in the sense that it is based on profits accruing to the taxpayer in respect of sales of silver. It is not the kind of income tax that this court has held may be imposed on the basis of transactions completed before the Act was passed.

The very nature of the present tax, applying as it does to profits without reference to when the silver was acquired, shows that it was designed purely as a revenue-raising measure, because it applies to sales of silver occurring after May 15, 1934 even though the silver had been acquired years before.

(A) *The retroactive application of the silver tax was designed purely as a revenue-raising measure.*

The Government's argument that the silver profits tax was designed not only to raise revenue but also to deter speculators from competing with the Government, after the President's message of May 22, 1934, had given notice of the Government's intention to purchase large quanti-

ties of silver at a maximum price of 54 cents per ounce, is clearly specious. Only in so far as the tax retarded buying would it reduce competition with the government by outside purchasers. Respondent had already bought his silver and no attempt was made to tax that transaction. Far from running counter to the Government's silver purchase program, the *selling* of silver by private holders would promote that program; the greater the amount of silver offered for sale the better the Government's opportunity for acquiring the desired amount of silver at a fair price.

This point was strongly brought out in the following statement in the opinion of the Court below (p. 7 of the Transcript of Record):

> "What we have said above applies to purchase and sales of silver after the passage of the act and when the Government had begun action thereunder. Then, as we have said above, if one contemplating the purchase of silver knew that a heavy tax would be imposed on any gain which resulted therefrom he would be quite likely to refrain from making the purchase in this country. But when the purchase was made before the silver purchase law was proposed, as it was in the instant case, we are at a loss to understand how putting a tax on the profits which might be made from subsequent sales could by any possibility affect the workings of the Act. The purchase had already been made. If it or any number of purchases made before the act was contemplated had any effect upon the price of silver, putting a tax on the sale would not change the result. We may concede, as we have above, that the tax might have some effect in the way of stopping future purchases of silver in this country but after the purchase has been made a tax levied upon the profits therefrom can serve

> no purpose but to bring some revenue into the Treasury. The market price of silver would remain the same to the Government or any other party and the enforcement of the act would in no way be assisted by the application of the tax under the circumstances presented by the plaintiff's case."

A tax on profits from sales of silver might be an appropriate supplement to the Government's monetary policy designed to mitigate the fluctuation in the world price of silver and to increase the amount of silver in our monetary stocks. But this is far from establishing the argument that the *retroactive feature* of the silver tax was justified as an auxiliary to the Government's monetary policy.

A similar argument was advanced by the Government in the *Untermyer* case, where it was pointed out that the Revenue Bill for 1924 proposed a drastic (50%) increase in the rates of estate tax, that the general tendency to escape estate taxes by making gifts *inter vivos* would be greatly accentuated by this proposed increase in rates, unless curbed by the threat of a retroactive gift tax, and that the retroactive feature of the gift tax should be sustained as an auxiliary to the Government's established power of taxing decedent's estates. But as is apparent from the decision in that case, the Court found the argument unconvincing.

Petitioner, attempting to show that the retroactive tax was designed to mitigate fluctuations in the world price of silver between the date of the introduction of the Silver Purchase Act and its passage, declares at p. 27 of its brief:

> "The Government could not enter the market as would a prudent buyer urged by such a necessity. The silver purchase policy of Congress was necessarily heralded

> to the world by the processes of formulating the legislation. The Government, accordingly, was in the position of bargaining with speculators who would know its position in advance."

But this argument is obviously unsound, in view of the following considerations:

In the first place, the Act was not made retroactive merely to the date (May 22) when a Silver Tax Bill was introduced in Congress, but to May 15th, a week before that date.

In the second place, the President, in outlining the Government's monetary policy, did not recommend that the silver tax be made retroactive. The retroactive feature of the tax was initiated by Congress itself, and that the dominant, if not the sole, purpose of making the tax retroactive was to produce revenue, not as an adjunct to the Government's monetary policy, is established by the report of the Ways and Means Committee of the House, quoted on page 11 of the Government's brief, in which the Committee said:

> "The tax being in the nature of a profits tax covers transactions taking place prior to enactment. Were this provision not included in the bill, the policy of equitably reimbursing the Government for the increase which its action may bring to the price of silver could be easily obstructed."

Petitioner attempts to bolster its argument that the retroactive silver profits tax is an implement of the Government's monetary policy, by pointing out that the French Republic, in its Monetary Law of October 1, 1936, provides for a special tax "comparable to the one involved in the present case". (Pages 17 and 18 of the Government's

brief.) This French tax, however, far from being analogous to our silver profits tax, brings out by contrast the very point which the Court below emphasized in its opinion, quoted above.* The French tax does *not* apply to profits on operations *commenced prior to the retroactive date specified in the act.* It applies exclusively to net profits ("benefices nets") from

> "liquidations des operations * * * engagees entre le 21 et 26 Septembre 1936"

that is, to profits from *operations entered into* between September 21 and 26, 1936. Profits from transactions entered into before, even though consummated after, September 21st are not taxed.

Reduced to its final terms, is not the Government's argument on the monetary point that the silver profits tax should not be judged as a tax because it is more than a tax; to-wit: a penalty for competing with the Government in the silver market? And if the so-called tax is a penalty, is not the statute which imposes it a penal statute, and to the extent that it applies to acts committed prior to the enactment of the statute, unconstitutional as an *ex post facto* law? Only recently this Court had occasion to hold in *United States* v. *Constantine,* 296 U. S. 287 (1935), that a so-called special federal tax on conducting a liquor business, contrary to state laws, was essentially a penalty, and therefore unconstitutional as an invasion of the police power reserved to the states.

For reasons stated above, we maintain that there is no sound basis for construing the silver tax as anything but a real tax. But if the tax was designed as a penalty, the

*Art. 14 of the French Monetary Law of October 1, 1926, published on page 1043 of the Journal Official of October 2, 1936, reads as follows: "Il est institué une taxe extraordinaire de 50 p. 100 sur les benefices nets qui resultront des comptes de liquidations des operations a terme engagées entre le 21 et 26 Septembre 1936 sur les bourses francaises des valeurs, a l'exception des operations effectuées sur le fonds d'Etat francais."

application of the tax to past transactions would, we submit, violate Article I Section 9 of the Constitution providing that no *ex post facto* law shall be passed by Congress.

(B) *The present tax is not the kind of tax on income that this court has held may be imposed on the basis of transactions completed before the Act was passed.*

The regular Federal income tax is not on specific transactions or even on an aggregate of transactions but on *net* income. Various income-producing transactions within the tax year are, it is true, taken into account in arriving at the amount of the net taxable income to which the tax is to be applied. But these transactions are only one part of a hodge-podge comprising also various deduction and credit items occurring within the same tax year, which frequently entirely offset the sum of the income transactions leaving no statutory net income on which to base the rates of tax prescribed by the statute. This feature of our income tax brought out in *Peck* v. *Lowe*, 247 U. S. 165 (1918), sustaining the federal income tax on the net income of a taxpayer engaged in the exporting business, in which Mr. Justice VAN DEVANTER, delivering the opinion of this Court, said (p. 175):

> "At most, exportation is affected only indirectly and remotely. The tax is levied after exportation is completed, after all expenses are paid and losses adjusted, and after the recipient of the income is free to use it as he chooses. Thus what is taxed—the net income—is as far removed from exportation as are articles intended for export before the exportation begins."

The silver tax, on the other hand, is a tax on specific transactions; the tax base and rates of tax are not af-

fected by other income which the taxpayer may receive or deductions to which he is entitled, in computing net taxable income subject to income tax. The tax is not even one on *net* income from the transactions in silver, but is to a large extent on gross profits, because, while the Act provides for the deduction of "allowed expenses", Article 44 of Treasury Regulations 85, defining what expenses shall be allowed, specifically provides that "interest, taxes, and charges in the nature of overhead may not be included in the allowed expenses." The silver tax does not take past transactions into account, along with various other facts, merely as a reasonable way of arriving at the taxpayer's presumable ability to pay; it imposes a tax on the past transactions as such. Such a tax, however classified, is of the same general type as that which this court, in the *Untermyer* case, held could not be retroactively imposed on transactions completed before its enactment.*

The Government contends that the decisions of the United States Supreme Court in *Brushaber* v. *Union Pacific Railroad Company,* 240 U. S. 1, and *Lynch* v. *Hornby,* 247 U. S. 339, which sustained the constitutionality of the Income Tax Law of October 3, 1913, imposing a tax based on net income from March 1, 1913 to December 31, 1913, establish that even a brand new income tax law can be retroactively applied.

There are two decisive answers to such a contention. In the first place, if the 1913 income tax was in fact a retroactive tax in the sense that the gift tax of 1924

*If the silver profits tax were construed to be an "Income tax" within the meaning of Section 23(c) of the Revenue Act of 1934 the tax could not be deducted in computing net income subject to the regular normal tax and surtax because this prohibits the deduction of federal income taxes in computing net taxable income, and taxpayers subject to the highest brackets of income tax would be taxable on profits derived from the sale of silver at an aggregate rate of 113%; 50% silver profits tax, in addition to a 59% surtax and 4% normal income tax.

and the silver tax now in question are retroactive, the decisions in the *Brushaber* and *Hornby* cases must be regarded as having been overruled by the decision in the *Untermyer* case. Indeed, counsel for the Government in the *Untermyer* case strenuously argued that if the Court held the retroactive feature of the 1924 Gift Tax Law unconstitutional, this would in effect overrule the decisions in the *Brushaber* and *Hornby* cases.

The second answer is that the Act of October 3, 1913 was not in any true sense a retroactive statute. That Act provided for the assessment and payment in June 1914 of a tax computed on the net income of the taxpayer for the period from March 1, 1913 to December 31, 1913. The figure of net income on which the tax was based was one which did not become crystallized or determinable until December 31, 1913, almost three months subsequent to the enactment of the statute. December 31, 1913, not March 1, 1913, was the effective date of that Act.

In the present case the tax is based on specific transactions consummated prior to the enactment of the Act. These transactions are not mere items entering into a fluctuating quantity that will not be definitely fixed until a time subsequent to the enactment of the statute, but themselves form an independent basis for the imposition of the tax.

The decisions relied on by the Government do not support the contention that wholly new taxes on business transactions can be subject to retroactive taxation.

On page 43 of its brief, the Government cites and discusses three cases in support of its contention that wholly new excise taxes on business may be retroactively applied. In two of these cases, *Patton* v. *Brady* and *Hecht*

v. *Malley,* the statute merely modified an existing tax, and in the third, *Billings* v. *United States,* the tax was not in fact retroactive. These cases do not therefore sustain the Government's contention.

Unconstitutionality of Retroactive Tax Will Not Affect Remainder of Act.

Congress apparently doubted the validity of the retroactive feature of the silver purchase tax and took pains (1) completely and clearly to separate the retroactive feature of the Act from the rest of the Act, and (2) to provide for a separate return showing all taxable silver transactions during the retroactive period.

Subdivision 10 of Schedule A of Title VIII of the Revenue Act of 1926, as added by the Silver Purchase Act of 1934, provides that:

> "This subdivision shall apply (1) with respect to all transfers of any interest in silver bullion after the enactment of the Silver Purchase Act of 1934, and (2) with respect to all transfers of any interest in silver bullion on or after May 15, 1934, and prior to the enactment of the Silver Purchase Act of 1934, except that in such cases it shall be paid by the transferor in such manner and at such time as the Commissioner, with the approval of the Secretary of the Treasury, may by regulations prescribe, and the requirement of a memorandum of such transfer shall not apply."

An entirely separate provision is likewise made in the regulations for retroactive transactions, Reg. 85, Art. 70 (C. C. H. Federal Tax Service, 1935, Vol. II, § 3092). And a separate form of return is provided (Form 4).

Accordingly, no interference with the operation of the remainder of the Silver Purchase Act would be involved

in holding the retroactive tax feature unconstitutional. It is separable substantively and administratively.

Conclusion.

The retroactive silver tax is not in form or in practical effect an increase in the income tax. It is an excise tax on silver transfers. It was imposed for the first time as part of the Federal tax system by the Silver Purchase Act. To the extent that it is imposed retroactively upon a legitimate transfer which was irrevocably completed at a time when no excise tax thereon was payable, it is so unreasonable and arbitrary as to be unconstitutional under the due process clause of the Fifth Amendment. *Untermyer v. Anderson, supra.* It is pure speculation to argue that the Respondent's profit on the transactions which were taxed was due to Governmental action with respect to silver, and that a retroactive tax upon the profits is therefore "equitable", nor was the *retroactive tax feature* of the Silver Purchase Act enacted as a necessary adjunct and aid to the Government's monetary policy.

The retroactive application of the tax is no different in principle from the retroactive application of the gift tax of 1924 and the decision of the United States Supreme Court holding such retroactivity unconstitutional is decisive of the present case.

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